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SEP 10

No. 351

In the Supreme Court of the United States

OCTOBER TERM, 1930

A. JAMES ECKERT, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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MEMORANDUM FOR THE RESPONDENT

The respondent does not oppose the petition in this case.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 12–17) is reported in 17 B. T. A. 263. The opinion of the Circuit Court of Appeals (R. 27–30) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 9, 1930. (R. 30.) A petition for rehearing was denied July 7, 1930. (R. 35.) The

petition for a writ of certiorari was filed August 14, 1930. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

In 1925 petitioner and another were required by a bank to substitute their own notes for notes of a corporation which they had endorsed. At this time the corporation had no assets, had discontinued business, and was in process of dissolution. Petitioner did not in 1925 pay any cash to the bank on the notes which he made in that year.

In computing his net income for that year was petitioner entitled to deduct any portion of the notes as a "debt ascertained to be worthless and charged off within the taxable year" under Section 214 (a) (7) of the Revenue Act of 1926?

STATUTES INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9, 27, 69:

> SEC. 214. (a) In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (7) Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part;
>
> * * * * *
>
> (U. S. C. App., Title 26, Sec. 955.)

EFFECTIVE DATE OF TITLE

SEC. 286. This title shall take effect as of January 1, 1925, except that section 257 and sections 271 to 285, inclusive, and this section, shall take effect on the enactment of this Act.

STATEMENT

The facts are not in dispute (R. 12–14):

Prior to 1922 the petitioner and William A. Ainsworth were engaged in business as partners. In 1922 they organized a corporation which acquired all of the assets and assumed all of the liabilities of the partnership, including certain notes, totaling $25,419.65, payable to and held by the Citizens Trust Company of Utica, New York, for money loaned to the partnership. The bank subsequently accepted notes executed by the corporation for the partnership notes. Between 1922 and 1925 the corporation issued several additional notes in the amount of $19,375.25, in favor of the same bank for loans. All of the notes issued by the corporation in favor of the bank were indorsed by the petitioner and Ainsworth.

In September, 1925, the bank made a demand upon the corporation for payment of the latter's notes. Subsequently, in 1925, the corporation discontinued business and proceeded to wind up its affairs, its assets on dissolution being insufficient to pay the amount due on the notes in excess of about $600. This amount was paid on the notes by the corporation in December, 1925, leaving an unpaid

balance of $44,800. Concurrently with the payment of $600 by the corporation, the petitioner and Ainsworth delivered to the bank their joint note for $44,800 in settlement of their liability as indorsers of the corporation's notes and in return received the corporation's notes stamped "paid." These notes were subsequently destroyed by the petitioner.

The liquidation of his liability as an indorser of the corporation's notes did not involve the payment of any cash. The petitioner has never collected anything on the notes he and Ainsworth paid. He did not keep books of account. His return for the taxable year was filed on the basis of cash received and disbursed.

The Commissioner of Internal Revenue declined to allow any amount of the notes as a deduction from gross income on the ground that no cash payments were made on the notes during the taxable year and determined a deficiency for the year 1925 in the sum of $3,378.89.

The Board of Tax Appeals held that the petitioner was not entitled to a deduction of the amount claimed, either as a loss or as a worthless debt of the corporation and approved the Commissioner's determination. (R. 17.) The Circuit Court of Appeals for the Second Circuit affirmed the Board's determination. (R. 30.)

DISCUSSION

The ultimate basis upon which the Circuit Court of Appeals sustained the determination of the

Commissioner appears in the following extract from the opinion (R. 29–30):

> The taxpayer not having sustained a loss because he did not pay the note or any part thereof in the year 1925, the Commissioner properly held that he was not entitled to this deduction. Nor is the taxpayer entitled to a deduction under clause 7 as a debt ascertained to be worthless and charged off during the year, because the debt was worthless when the taxpayer acquired it.

The decision in this case seems to be in conflict with that of the Circuit Court of Appeals for the Seventh Circuit in *S. R. Davis* v. *Commissioner*, rendered October 24, 1928, and not reported. That Circuit Court of Appeals reversed without opinion the decision of the Board of Tax Appeals. (9 B. T. A. 755.) The findings of fact in the *Davis case* (9 B. T. A. 755, 756) disclose that the notes were not worthless when received, and that previous to the deduction they had been taken into the taxpayer's investment accounts as an asset. But as it seems doubtful whether it was because of these facts that the Circuit Court of Appeals for the Seventh Circuit decided the case in favor of the taxpayer, the two cases appear to be in conflict.

CONCLUSION

In view of the conflict of the decision in the instant case with the decision of the Circuit Court of

Appeals for the Seventh Circuit in *Davis* v. *Commissioner*, we do not oppose the issuance of the writ.

Respectfully submitted.

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